IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

COMPANY PETITION No. 190 of 2006
In
COMPANY APPLICATION No. 405 of 2006

For Approval and Signature:

HONOURABLE MR.JUSTICE JAYANT PATEL

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the civil judge ?

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RISHIROOP RUBBER (INTERNATIONALTD. - Petitioner(s)
Versus
. - Respondent(s)

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Appearance :
MR NAVIN K PAHWA for Petitioner(s) : 1,
MR PURVISH J MALKAN for Respondent(s) : 1,

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CORAM : HONOURABLE MR.JUSTICE JAYANT PATEL

Date : 16/07/2007

ORAL JUDGMENT

1. The present petition is preferred for seeking sanction of scheme of arrangement at Annexure-(C) to

be made binding to whole shareholders and the creditors of the petitioner company. The scheme of arrangement produced at Annexure (C) inter alia provides for proposal in the scheme as under:

> “The scheme of arrangement proposes for adjustment of accumulated losses of Rs. 10.56 Crores as appearing in the balance sheet of the company as at 31.03.2006 by setting off the same against capital reserves of Rs. 15.61 Crores of the Company. The company also proposed to convert the balance capital reserves of Rs. 5.05 Crores into the General Reserves”

2. The aforesaid is titled as the scheme of arrangement by the petitioner for which the sanction is prayed of this Court under the jurisdiction as per section 391 read with section 394 of the Companies Act (hereinafter referred as an “act”).

3. This Court (Coram: M.R. Shah, J.) on 10.10.2006 had passed an order of admitting the petition and the notice was issued to the Central Government through Regional Director and the publication was also made in “Indian Express” [English Daily], and “Sandesh” [Gujarati Daily], both Ahmedabad editions and the publication in the Government Gazette was dispensed with.

4. Mr. P.J. Malik, Assistant Registrar of company has filed an affidavit communicating the comments of the Regional Director vide letter dated 18.01.2007 which inter alia reads as under:

> “it has been decided that to bring to the notice of the Hon'ble High Court of Gujarat that clause No. 3A of the Scheme read with explanatory statement under section 393 of the Companies Act, 1656 transpires that the Company received compensation from World Bank through IDBI during the F.Y. 2005-2006 and petitioner credited the same to capital reserves. By this Scheme the petitioner seeks from writing off accumulated losses of Rs. 10.56 crores as appearing in the Balance Sheet as at 31.3.2006 and set off the same against capital reserves of Rs. 15.61 crores and remaining capital reserve of Rs. 5.05 crores shall be converted into general reserve. There is no specif provision in the Companies Act, 1656 for setting off capital reserve against accumulated losses and also for converting capital reserve into general reserve. However, the petitioner seeks sanction of the scheme under section 391-394 of the Companies Act, 1956. the provisions of section 391-394 apparently not applicable to the instant petition.”

5. Therefore, the aspects which arise for consideration is the maintainability of the present petition vis-a-vis scope of jurisdiction of this Court under

section 391 read with section 394 of the Act.

6. Mr. Pahwa, learned Counsel for the petitioner contended that the word any scheme of arrangement for which sanctions required is wide enough to cover all type of arrangement and in his submission, since there is alteration in the capital reserves of the company by the proposed scheme of arrangement, the matter would fall within the jurisdiction of this Court for grant of sanction. He submitted that there is no objection by the Central Government except on the point of maintainability and therefore, the sanction be granted by this Court. In support of his submission, he relied upon the provisions of section 391 read with section 394 of the Companies Act and also the commentaries of the book Palmer's Company Law for contending that the arrangement would include various contingencies and therefore, it falls within th e jurisdiction of this Court. He also relied upon the extract of Halsbury's Laws England providing the manner of word “arrangement”. He relied upon the decision of this Court in the case in **Maneckchowk and Ahmedabad Manufacturing Co. Ltd., reported in (1970) 40 Company Case page 819,** more particularly observation at ground 4 and contended that section 391 of the Act provides a

complete code for reconstruction of the company which may include reorganisation of its capable as part of the scheme of compromise and arrangement. Therefore, he contended that as the matter falls within the jurisdiction of this Court under the Companies Act, the observations raised by the Central Government is not maintainable.

7. Section 391 and Section 394 of the Act which are relevant for the purpose of the present petition reads as under:

"**Sec 391- Power to compromise or make arrangements with creditors and members.**

(1) Where a compromise or arrangement is proposed

(a) between a company and its creditors or any class of them ; or

(b) between a company and its members or any class of them ;

the [Tribunal] may, on the application of the company or of any creditor or member of the company, or, in the case of a company which is being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the [Tribunal]directs.

(2) If a majority in number representing three-fourths in value of the creditors, or class of creditors, or members, or class of members, as the

case may be, present and voting either in person or, where proxies are allowed under the rules made under section 643], by proxy, at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the [Tribunal] be binding on all the creditors, all the creditors of the class, all the members, or all the members of the class, as the case may be, and also on the company, or, in the case of a company which is being wound up, on the liquidator and contributories of the company :

> [Provided that no order sanctioning any compromise or arrangement shall be made by the [Tribunal] unless the [Tribunal] is satisfied that the company or any other person by whom an application has been made under sub-section (1) has disclosed to the [Tribunal] by affidavit or otherwise, all material facts relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company, the pendency of any investigation proceedings in relation to the company under sections 235 to 251, and the like.]

(3) An order made by the [Tribunal] under sub-section (2) shall have no effect until a certified copy of the order has been filed with the Registrar.

(4) A copy of every such order shall be annexed to every copy of the memorandum of the company issued after the certified copy of the order has been filed as aforesaid, or in the case of a company not having a memorandum, to every copy so issued of the instrument constituting or defining the constitution of the company.

(5) If default is made in complying with sub-section (4), the company, and every officer of the company who is in default, shall be punishable with fine which may extend to [one hundred] rupees for each copy in respect of which default is made.

(6) The [Tribunal] may, at any time after an application has been made to it under this section,

stay the commencement or continuation of any suit or proceeding against the company on such terms as the [Tribunal]thinks fit, until the application is finally disposed of.

(7) An appeal shall lie from any order made by a Court exercising original jurisdiction under this section to the Court empowered to hear appeals from the decisions of that Court, or if more than one Court is so empowered, to the Court of inferior jurisdiction. The provisions of sub-sections (3) to (6) shall apply in relation to the appellate order and the appeal as they apply in relation to the original order and the application.

Sec 394 Provisions for facilitating reconstruction and amalgamation of companies.

(1) Where an application is made to the [Tribunal] under section 391 for the sanctioning of a compromise or arrangement proposed between a company and any such persons as are mentioned in that section, and it is shown to the **[Tribunal].**

(a) that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of any company or companies, or the amalgamation of any two or more companies ; and

(b) that under the scheme the whole or any part of the undertaking, property or liabilities of any company concerned in the scheme (in this section referred to as a " transferor company ") is to be transferred to another company (in this section referred to as the " transferee company ") ;

the [Tribunal] may, either by the order sanctioning the compromise or arrangement or by a subsequent order, make provision for all or any of the following matters :

(i) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company ;

(ii) the allotment or appropriation by the transferee company of any shares, debentures, policies, or other like interests in that company which, under the compromise or arrangement, are to be allotted or appropriated by that company to or for any person ;

(iii) the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company ;

(iv) the dissolution, without winding up, of any transferor company ;

(v) the provision to be made for any person who, within such time and in such manner as the [Tribunal] directs, dissent from the compromise or arrangement ; and

(vi) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out :

[Provided that no compromise or arrangement proposed for the purposes of, or in connection with, a scheme for the amalgamation of a company, which is being wound up, with any other company or companies, shall be sanctioned by the [Tribunal] unless the [Tribunal] has received a report from the Company Law Board or the Registrar that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest :

Provided further that no order for the dissolution of any transferor company

> under clause (iv) shall be made by the [Tribunal] unless the Official Liquidator has, on scrutiny of the books and papers of the company, made a report to the [Tribunal] that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest.]

(2) Where an order under this section provides for the transfer of any property or liabilities, then, by virtue of the order, that property shall be transferred to and vest in, and those liabilities shall be transferred to and become the liabilities of, the transferee company ; and in the case of any property, if the order so directs, freed from any charge which is, by virtue of the compromise or arrangement, to cease to have effect.

(3) Within [thirty] days after the making of an order under this section, every company in relation to which the order is made shall cause a certified copy thereof to be filed with the Registrar for registration. If default is made in complying with this sub-section, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to [five hundred] rupees.

(4) In this section

> (a) " property " includes property, rights and powers of every description ; and " liabilities " includes duties of every description ; and
>
> (b) " transferee company " does not include any company other than a company within the meaning of this Act ; but " transferor company " includes any body corporate, whether a company within the meaning of this Act or not.

If the aforesaid provisions are read with the commentaries in Palmer's Company Law upon which

reliance is placed by Mr. Pahwa, at page 1134 while defining scope of section 425 (on the basis of which the similarity is pressed in service) the relevant of which reads as under:

> “The aid of the section may be invoked when it is not otherwise possible to make some arrangement or compromise which would be in the interest of the company and the other party of parties to the arrangement. It can be used whether the company is going concern or is in the course of winding up. It will not normally be necessary to invoke the section where it is desired to alter rights attached by the articles to a class of shares; but if the rights are defined in the memorandum, they cannot be altered unless either the memorandum itself provides procedure for alteration (section 17(2)) or all members agree to the change (Section 123(5)).”

Further in the very book, at page 1135 in the commentaries under the head of the meaning of “compromise” or “arrangement” at page 1136, it has been inter alia stated as under:

> “In 1981 the question arose as to the meaning of an arrangement “between” the company and its members. In Re Savoy Hotel Ltd. a shareholder asked the Court to call a

> separate meeting of the holders of each of the two classes of shares in order to approve a proposed scheme under which that shareholder would acquire all the shares of Savoy company. This was opposed by the Savoy directors and one of their arguments was that this could not be described as an arrangement "between" the company and its members so that the section did not apply. Nourse J. held that the word "arrangement" had a wide interpretation, an since the scheme would affect the contractual relationship subsisting between the company and its members by requiring the company to register the applicant in place of existing members as the holders of the company's shares, the rights and obligations between the company and its members were sufficiently affected for the scheme to be an arrangement between them. All the Re. N.F.U. Development Trust Ltd. case decided said the judge, was that these should be some element of give an take." (Emphasis supplied)

8. Therefore, it appears that in cases where contractual rights between the parties are to be affected by the scheme of compromise or arrangements or to be altered or if any specific rights under the express provisions of law are also to be altered, possibly it may require the sanction by this Court under the Companies Act. It has not been

demonstrated to the satisfaction of the Court that there is any alteration of the contractual rights of the parties, may be the shareholders or creditors.

9. Mr. Pahwa, learned Counsel for the petitioner also attempted to submit that since the reserves as per the provisions of section 78 of the Act in the share premium account as shareholder cannot be transferred to the profit and loss account of the company, it can be said that similar situation would prevail if the company is to alter the present reserves by setting off the same against the losses and by transferring any part to the general reserves.

10. It appears that for the reserves in the share premium account, there is express provision under the Companies Act which may give right to the shareholders as per statute and creates prohibition against transfer of such reserves. Such is not a situation in the present case. No statutory provisions under the Companies Act prohibiting the setting off the reserves against the accumulated losses is brought to the notice of this Court. If company has received specific fund from the world Bank, it may be required to abide by the terms and conditions of such disbursement of the fund. However, utilization of the said fund by the company

for setting off of the losses, is no aspects where the rights of equity shareholders or the debenture holders or the creditors may be secured or unsecured are to be altered nor as observed earlier statutory prohibition is brought to the notice of this Court.

11. Mr. Pahwa, learned Counsel appearing for the petitioner relied upon the decision of High Court of Delhi in case of Allianz Capital & Management Services Ltd., reported in [2005]63 SCL 496 (DELHI) for contending that the alteration of the reserves was considered as the scheme of arrangement and the sanction was granted by the High Court of Delhi.

12. Firstly, the facts stated in the said decision at para 1 inter alia provided not only for the alteration in the reserves, but the alteration in the balance of the share premium account, of the debenture share premium for which, there is express provision under the Act. Therefore, the fact situation of the present case cannot be the same. Moreover, in the said decision as no objection was raised for transfer of the capital reserves of to the profit and loss account by the Central Government, the High Court of Delhi had no occasion to examine the question as to whether such scheme of arrangement falls within the scope and ambit of section 391 read with section 394 of the Act and

therefore, the said decision is of no help to the petitioner.

13. Similarly the reliance placed upon the decision of this Court in the case of **Maneckchowk (supra)** is ill-founded inasmuch as if the matter falls within the jurisdiction, thereafter the company court itself has power to decide the direct dispute and incidental thereto and for such purpose it is complete code by itself. In the present there is no alteration of the rights by contractual relationship or by statutory provisions and therefore, observation made in the said decision cannot be read as basis for seeking sanction of the present scheme of arrangement.

14. Hence, it appears that the present scheme of arrangement for which the sanction is sought in the present petition would fall outside the scope and ambit of section 391 read with section 394 of the Act.

15. In view of the above, the present petition is dismissed on the point of jurisdiction.

(JAYANT PATEL, J.)

Suresh*